

Don't Let Business Failures Affect Your Bank

Understanding Nebraska Law Regarding Outstanding Tax Obligations

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Introduction

Business failures are an all-too-common occurrence in the United States and in Nebraska specifically. When this happens, dreams are crushed, livelihoods placed at risk, and many people, institutions, and organizations are damaged. One of those at risk may be a financial institution that has loaned funds to the business dependent on its success. Another may be the people of Nebraska, through their government institutions.

The Nebraska Department of Revenue (Department) is responsible for the enforcement of the Revenue laws of Nebraska and the administration and collection of more than 30 types of taxes. Often businesses faced with financial stress delay or stop paying taxes that are owed so they can pay other obligations. This outstanding tax liability may be unknown to other creditors of the business.

When business failure occurs, the law requires certain actions to be taken to satisfy any outstanding tax obligations. These actions may be at odds with any plans developed by business owners and creditors to plan a way out. This article is to familiarize bankers with the revenue laws of Nebraska with regard to tax obligations and the powers granted to the Department to collect these taxes. Hopefully, it will help minimize misunderstandings between the Department and the banking community in situations when there is too little money to go around.

The Unique Status of Trust Fund Taxes

The Department administers and collects more than 30 different types of taxes. Nearly all are collected from business entities. These range from the obscure, like the litter fee, to the major taxes like sales and income taxes. Even sales and individual income taxes paid by individuals, are collected primarily through businesses. As most of us know, merchants collect state and local sales taxes from purchasers along with the purchase price of the product purchased. Under Nebraska law, sales taxes collected “constitute a debt owed by the retailer to this state.” [Neb. Rev. Stat. § 77-2703\(1\)\(a\)](#).

Similarly, the individual income tax is primarily collected by withholding the tax from employees or other persons providing personal services. Under Nebraska law, any amount deducted and withheld from the earnings of employees “shall constitute a trust fund in the hands of the employer or payor and shall be owned by the state.” [Neb. Rev. Stat. § 77-2757](#). While the wording of these two statutes is different, both are considered money taken from the individual taxpayer that is rightfully owned by the people of Nebraska and not the business. We call both sales taxes collected and withholding “trust fund taxes” to reflect their unique status in the revenue laws of this state.

This unique status can also be found in information the Department provides businesses when they first become licensed to collect Nebraska taxes. The Department's Information Guide on [“Statutory Responsibilities for Collecting, Reporting, and Remitting Sales Taxes and Income Tax Withholding”](#) begins by describing trust fund taxes and recommending that amounts collected from customers for sales tax or deducted from employees for withholding be kept in a separate bank account and never used for business operations. This guide further directs that these taxes **cannot** be used for any other purpose. This separate bank account should only hold trust fund taxes, even though the business may also owe income taxes, use taxes, property taxes, or any number of other taxes on its own accord.

Many businesses, of course don't do this. What the Department often finds, is that when businesses suffer financial stress, they treat trust fund taxes like any other obligation of the business, despite their unique status.

Tax Liens

The law governing establishment and enforcement of state tax liens is governed by the Uniform State Tax Lien Registration and Enforcement Act ([Neb. Rev. Stat. §§ 77-3901 through 77-3908.](#)) If any person liable to pay any tax neglects or refuses to pay after a demand, the tax and any associated interest or penalties establishes a lien in favor of Nebraska upon all property and rights owned by the taxpayer or acquired later prior to expiration of the lien. ([Neb. Rev. Stat. § 77-3904](#)) Under the procedures of the Department, the Demand for Payment, which triggers this statutory lien, is issued after the assessment of the tax is final, meaning any protest or appeal period has expired and the amount in the demand is no longer open to adjustment.

This lien will expire after three years unless recorded. Usually, the Department does not record liens immediately. The threat of recording a lien can often provide leverage that causes the taxpayer to pay the taxes owed or reach a payment agreement. Once the lien is recorded, it does not expire for ten years and may be renewed thereafter for subsequent ten-year periods. The priority of the lien is based upon the date recorded, except with regard to the IRS, in which case, the priority of the state tax lien is established based on the date the tax was assessed.

A state tax lien may be enforced by the Department by garnishing wages, levying bank accounts, or seizing and selling property of the taxpayer. ([Neb. Rev. Stat. § 77-3906](#)) It is important to point out that these measures can be pursued regardless of whether or not the state tax lien is recorded. Often these collection actions are the best collection tool available after the business has closed and tax liability remains, but not always.

Successor Liability

Successor liability is a collection method that is available to the Department in some circumstances that may be a trap for the unwary. [Neb. Rev. Stat. § 77-2707](#) provides that “[i]f any person liable for any sales or use tax under the provisions of the Nebraska Revenue Act of 1967 sells out his business or stock of goods or quits the business, his successor or assign shall withhold sufficient of the purchase price to cover such amount until the former owner produces a receipt from the Tax Commissioner showing that it has been paid or a certificate stating that no amount is due.” This statute goes on to provide that if the purchaser fails to either obtain the clearance letter from the Department, or withhold the funds, the *purchaser* becomes liable for the entire amount up to the

amount of the purchase price, *valued in money*. Thus, the statute imposes this liability up to the value of the entire transaction, not just the cash portion.

Under this statute, purchasers of a business, or the assets of a business have a statutory obligation to make sure that any sales tax liability is paid before the seller receives anything from the sale. The penalty for failure to do so is transfer of the liability to the purchaser, up to the amount of the purchase price, *valued in money, including any assumption of debt*. This obligation must be addressed first, before any liens are considered. While successor liability may exist in connection with **any** sale of a business, it often comes into play when a creditor is attempting to arrange transfer of the business and the underlying loan to another operator. Successor liability may be a deal killer in these cases.

The statute cited above applies only to sales and use taxes, but a similar statute and Nebraska case law extends this treatment to income taxes and withholding. (See [Neb. Rev. Stat. § 77-27,110](#) and *Gottsch Feeding Corp. v. State*, 261 Neb. 19, 621 N.W.2d 109 (2001)).

Corporate Officer Liability

[Neb. Rev. Stat. § 77-1783.01](#) provides that any corporate officer or employee that had a duty to collect, account for, or remit any taxes imposed on the corporation is personally liable for any willful failure to cause the corporation to pay the tax. Willful failure to pay the tax can be established if the Department shows that the corporate officer or employee knew taxes were due, had funds available, and paid any other creditor.

This is a powerful collection tool that is useful if a business that is a corporation is sold or liquidated and there is simply not enough money to go around. The Department may be able to establish willful failure to pay taxes by one or more former owners or responsible employees. Once that assessment is final and can no longer be appealed, the Department may proceed to issue a Demand for Payment and garnish wages, levy bank accounts, or seize and sell property of the individual corporate officer or employee.

Protecting the Interests of Nebraskans

Often when businesses are struggling financially, those businesses fall behind in paying taxes when due. When that happens, the Nebraska Department of Revenue has many collection tools available to protect the interest of the people of Nebraska. Some of these tools operate separate and apart from the recorded lien process. To avoid surprises, bankers and other creditors need to be aware of these tools and investigate possible tax liabilities when working with debtors.

This is especially true if the plan revolves around selling the business to a new operator. Because the successor liability statute can stop the sale in its tracks, creditors need to find out early if there are sales or use taxes or withholding liabilities and how much. To receive clearance from the Department for the sale to go through, contact the Department and include a [Power of Attorney appointment \(Form 33\)](#) from the selling business. This form authorizes the Department to reveal confidential taxpayer information to the bank or other creditors.

Once everyone is aware of all the liabilities and relative rights, the Department can work with the bank and other creditors in a joint effort to limit everyone's loss exposure as much as possible and allow the sale to take place.